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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1929.

No. 226

THOMAS A. EARLY, RECEIVER FOR THE FARMERS & MERCHANTS NATIONAL BANK OF LAKE CITY, PETITIONER,

vs.

FEDERAL RESERVE BANK OF RICHMOND, RESPONDENT.

BRIEF OF J. W. POLE, COMPTROLLER OF THE CURRENCY OF THE UNITED STATES, AS AMICUS CURIÆ, IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

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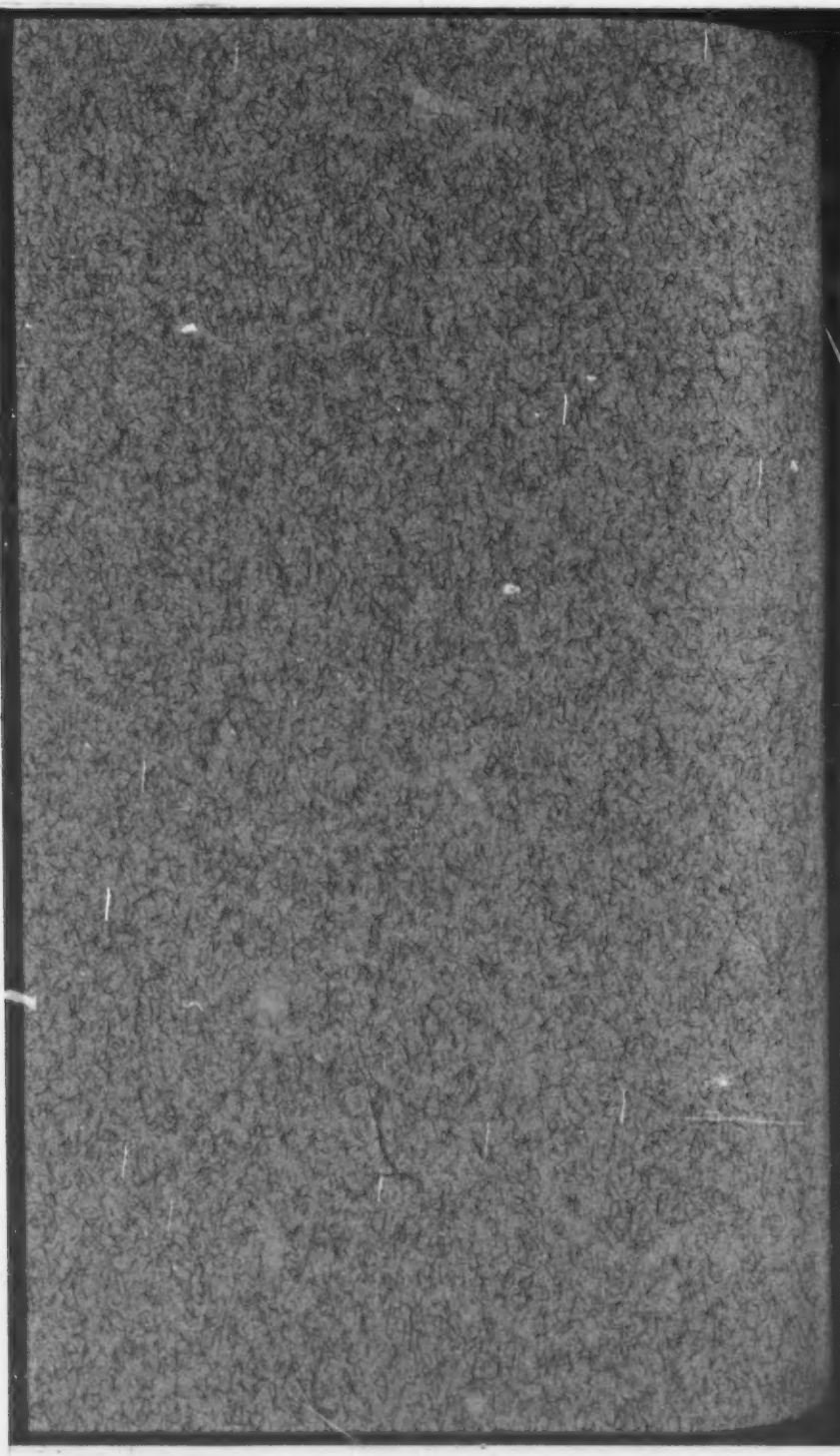

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vs.

FEDERAL RESERVE BANK OF RICHMOND, Respondent.

BRIEF OF J. W. POLE, COMPTROLLER OF THE CURRENCY OF THE UNITED STATES, AS AMICUS CURIÆ, IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Comes now, J. W. Pole, Comptroller of the Currency of the United States, and, by leave of Court first had and obtained, respectfully submits his brief as amicus curiæ, in support of the petition for writ of certiorari heretofore filed in the above entitled cause.

Foreword.

The Comptroller of the Currency is charged by law with the supervision of receivers of insolvent national banks, and with the collection and disbursement of monies incident to the administration of the estates of such banks. (Sections 5234-36, U. S. R. S.) In his petition for writ of certiorari, and supporting brief, the Receiver of the Farmers and Merchants National Bank of Lake City has given references to the opinions below, discussed the jurisdictional requirements, clearly and adequately stated the facts in the controversy and cited authorities in support of the petition, and consequently, to avoid repetition, the matters therein covered will not be repeated in this brief. The object here is primarily to emphasize certain phases of the matter concerning the importance of the decision from the standpoint of the administration of national banks, and the reasons why it is felt that this Court would be justified in reviewing the decision of the Circuit Court of Appeals.

Finality of Judgment.

The judgment of the Circuit Court of Appeals is not final in form but it is believed that it is unquestionably final in substance.

(a) All of the facts were stipulated, and only questions of law are involved.

(b) The District Court, upon the stipulated facts, found for the Receiver concerning the reserve deposit,

and the Circuit Court of Appeals, upon the stipulated facts, reversed that judgment, its language in its opinion in that connection being:

> "With respect to the deposit balance, therefore, our conclusion is that this is not recoverable by the Receiver but should be applied by the Reserve Bank upon the checks forwarded for collection * * *. (R., pg. 76.)
>
> "Our conclusion, therefore, is that the District Judge *erred as a matter of law* in finding for plaintiff with respect to the first cause of action, which relates to the deposit account, but that his finding with respect to the second cause of action, which relates to the stock liability, is correct. The judgment rendered will be set aside, therefore, and a new trial will be awarded on the first cause of action." (Italics inserted.) (R., pg. 77.)

(c) Counsel for Respondent Reserve Bank very courteously and fairly concedes, on page 2 of his brief in opposition, that only questions of law are involved; that the decision of the Circuit Court of Appeals disposes of all such questions completely; that such decision is in substance a determination of the controversy, even though not in form a final judgment, and that although he opposes the granting of the petition for writ of certiorari on other grounds, he concedes that the petition was filed at a proper time and joins with the petitioner

> "in respectfully requesting the Court to consider the questions presented as if the decision

of the Circuit Court of Appeals had been in substance as well as form a final judgment."

(d) It may be noted that Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (C. 229; 43 Stat. 936, 938), does not require that the judgment sought to be reviewed be final, and this Court has held that the application for certiorari may be granted notwithstanding the fact that the case has been remanded by the Circuit Court of Appeals for a new trial. United States *vs.* Gulf Refining Company, 268 U. S. 542; Spiller *vs.* Railroad, 253 U. S. 117; Forsyth *vs.* Hammond, 166 U. S. 506; American Construction Company *vs.* Railroad, 148 U. S. 372.

Under the circumstances it is felt that the finality of the judgment in substance, coupled with the importance of the issues involved, justify this Court in treating the judgment as a final judgment so far as concerns the consideration of same in granting or denying the petition for writ of certiorari.

Special and Important Reasons (other than the Alleged Errors of Law) Believed to Justify the Granting of the Petition for Writ of Certiorari.

It is felt that the Circuit Court of Appeals has decided an important question of Federal law, dealing with the administration of insolvent national banks, which has not been, but which should be, settled by this Court, and that the decision of the Circuit Court of Appeals is in conflict with the fundamental principles governing the administration of insolvent estates established by the decisions of this Court.

Section 5234 U. S. R. S. requires the Receiver, under the direction of the Comptroller, to collect and liquidate all assets of the bank, and Section 5236 U. S. R. S. provides that:

> "From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, *the Comptroller shall make a ratable dividend* of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated * * *."

The insolvent bank had on deposit with the Federal Reserve Bank of Richmond at suspension the sum of $22,088.48, and payment of same having been refused, the Receiver sued the Reserve Bank to recover the deposit, and the liquidation value of certain stock, as assets of the insolvent bank, so as to enable a pro rata distribution of the same to be made among the creditors as contemplated and directed by Sections 5234 and 5236 U. S. R. S. The Circuit Court of Appeals ruled that the value of the stock could be recovered, and the same is not here in question, but it also ruled that the Reserve Bank *must* retain such reserve balance and apply the same to the payment of the claims which certain of its depositors and customers had against the insolvent bank, said claims being based upon

checks drawn upon the insolvent bank which had been forwarded to the Reserve Bank for collection, the Reserve Bank in turn forwarding the checks to the insolvent bank for collection by letters of transmittal known as "cash letters." The result of the ruling of the Circuit Court of Appeals was that said depositors and customers of the Reserve Bank were, *by said ruling,* given a preferred status over the general creditors. The basis of the decision giving such preference was that said depositors and customers of the Reserve Bank had forwarded to the Reserve Bank for collection certain checks drawn upon the insolvent bank, and that, *by the terms of collection* agreed to and relied upon by all parties, said creditors acquired a *lien* upon said reserve balance. The application for writ of certiorari was filed to obtain a review of the ruling allowing said lien.

The terms of collection so construed are contained in the Reserve Bank's Circular No. 143 (R., pgs. 47 to 57) and the Reserve Bank's time schedule showing when the items in the cash letters become available for reserve and checking purposes (R., pgs. 57 to 59), and said Circular and time schedule are in turn based upon the terms of collection *prescribed by* Regulation J of the Federal Reserve Board, Series of 1924, (R., pgs. 43 to 47), which regulation is authorized by Section 16 of the Federal Reserve Act (12 U. S. C. A. 248 (m)). Said Regulation J applies to all Federal Reserve Banks, the provision of the regulation in that respect being:

> "Each Federal Reserve Bank shall exercise the functions of a clearing house and collect checks under the general terms and conditions hereinafter set forth." (R., pg. 44.)

Said Regulation J prescribes the terms and conditions under which said collections will be handled by the Reserve Banks, and specifically provides, in Section V thereof (R., pg. 45) that the banks sending items to the Reserve Banks for collection and clearance shall be bound by the terms and provisions of said regulation.

The regulation is therefore general in application, and the decision of the questions here involved will affect all Federal Reserve Banks and member banks handling items for collection. It will also have application to all insolvent national banks having reserve balances in Federal Reserve Banks at the time of failure and suspension and owing, at suspension, unremitted and unpaid cash letters. Consequently the decision has direct bearing upon the administration of the estates of such insolvent national banks by the Comptroller of the Currency under the Federal statutes governing such administration. In practically every case of failure of a national bank there are outstanding cash letters unremitted and unpaid, and if the decision of the Circuit Court of Appeals stands, the creditors of said insolvent banks owning the items contained in said cash letters will acquire, in consequence, a preferred status, at the expense of

the general creditors, and contrary to what is believed to be the true intent of Congress.

There is nothing contained in the Reserve Bank's Circular No. 143 and accompanying time schedule concerning the terms of collection and remittance which departs in substance from the terms and conditions prescribed by said Regulation J, and as a matter of fact Regulation J requires the promulgation by each Reserve Bank of such circulars and that the same shall not be inconsistent with the regulation, the language of the regulation in that respect, as contained in Section VI thereof, being as follows:

> "Each Federal Reserve Bank shall also promulgate rules and regulations *not inconsistent* with the terms of the law or of this regulation, governing the *details* of its check clearing and collection operations." (Italics inserted.) (R., pg. 47.)

Not only does said Circular No. 143 not depart from the requirements of Regulation J, but on the contrary it either adopts in substance or quotes verbatim the various provisions of Regulation J as its "terms of collection." By way of comparison in this respect see:

> Circular No. 143, "Conditions under which items will be received" (R., pgs. 49 to 51), and the adoption verbatim (R., pgs. 50 to 51) of the "Terms of Collection" contained in Section V of Regulation J. (R., pgs. 45 to 47.)
>
> Circular No. 143, "Availability of Proceeds" (R., pg. 52), adopting the substance of the pro-

visions concerning availability of proceeds contained in numbered paragraphs 2 and 3 of Section 4 Regulation J. (R., pg. 45.)

Circular No. 143, "Our Cash Letters to Member Banks" (R., pg. 55), relating to method of remittance and payment by collecting drawee bank, and corresponding provision in numbered paragraph 4 of Section V of Regulation J (R., pg. 46), said numbered paragraph IV of the regulation also being incorporated verbatim in Circular No. 143 under its "Terms of Collection." (R., pg. 51.)

It is therefore believed that there is no peculiar feature in the terms of collection in the instant case which can differentiate it in principle from collection cases arising under said Regulation J in all other Federal Reserve Banks, and it is believed, as before indicated, that the issues here involved are of sufficient general importance to merit consideration by this Court at this time. The question has never been passed upon by this Court, and never heretofore by a Circuit Court of Appeals, and, as hereinafter indicated, the Comptroller does not feel that the Circuit Court of Appeals has properly construed and interpreted said Regulation J and the circular of the Reserve Bank based thereon. The decision of this Court upon the merits of the question will render certain what is now an uncertain and troublesome phase of liquidation of the estates of insolvent national banks.

By way of illustration of the existing situation, it may be stated that during the pendency of this litiga-

tion the reserve balances of a number of insolvent national banks have been either wholly or partially withheld by Reserve Banks as a matter of protection to the Reserve Banks and in anticipation of possible suits against them by their depositors and customers, on the theory that the reserve balances of said insolvent national banks are subject to application for payment of cash letters outstanding at the time of suspension of said banks and unremitted and unpaid.

Merits of the Legal Questions Involved.

In view of the fact that the Receiver has filed a brief, containing full citations of authorities in support of his petition for writ of certiorari, no citations of cases will here be made, and there will be only a brief discussion of the merits from the standpoint of the basic and fundamental principles involved.

The question for determination is the right of the Reserve Bank to apply the reserve balance of the insolvent bank to the payment of the outstanding cash letters for which the insolvent bank had not made payment.

The Circuit Court of Appeals recognized that the reserve deposit could not be applied by way of offset, for the reason that the Reserve Bank was merely an agent for collection and there could be no offset of the claim of the Reserve Bank as such agent upon the claim against it by the insolvent bank for the reserve balance, due to such debits and credits not arising between the Reserve Bank and the insolvent

bank in the same capacity and there being, consequently, a lack of the mutuality necessary for offset. (R., pgs. 76-77.)

The Circuit Court of Appeals did hold, however, that the Reserve Bank could apply the reserve balance of the insolvent bank toward payment of the amounts of the unpaid cash letters, on the theory that under the terms of the contract between the parties (consisting of said Regulation J, said Circular No. 143, and said time schedule) the insolvent bank had agreed that the collection items contained in said cash letters should be charged against its reserve account at the expiration of three days, unless the items should before that time be returned, and that, by virtue of said agreement to such effect, the depositors and customers of the Reserve Bank owning said collection items acquired an equitable lien against said reserve account, and that the right to said equitable lien became fixed as soon as the insolvent drawee bank accepted and cancelled said checks and charged them to the accounts of the drawers. (R., pgs. 71-76.)

The specific question, therefore, is:

DID THE CUSTOMERS AND DEPOSITORS OF THE RESERVE BANK, WHO WERE OWNERS OF THE COLLECTION ITEMS CONTAINED IN THE UNPAID CASH LETTERS, ACQUIRE, BY VIRTUE OF THE COLLECTION CONTRACT, A LIEN AGAINST THE RESERVE BALANCE OF THE INSOLVENT NATIONAL BANK?

The provision primarily relied upon in support of the lien is contained in said Circular No. 143 under

the caption "Our Cash Letters to Member Banks" and is as follows:

> "Checks received by us drawn on our member banks will be forwarded in cash letters direct to such banks and each member bank will be required either to remit therefor in immediately available funds or to provide funds available to us to meet such cash letters within the agreed transit time to and from the member bank. Therefore, the amount of any cash letter to a member bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter. The right is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so." (R., pg. 55.)

The Comptroller of the Currency does not feel that the contract of collection between the parties gave the customers and depositors of the Reserve Bank who were the owners of the collection items a lien upon the reserve deposit of the insolvent bank and believes that the Circuit Court of Appeals was in error in so deciding.

(1) *Option of drawee bank either to remit for cash letters or to permit same to be charged against reserve account.*

It will be noted from the portion of Circular No. 143 above quoted that the drawee bank was

> "required *either to remit* therefor in immediately available funds *or to provide funds* available to us to meet such cash letters *within the agreed transit time* to and from the member bank. * * *"

It would seem clear from the foregoing that there was *no obligation upon the insolvent bank to pay the outstanding cash letters from its reserve account nor to preserve the reserve account intact for such purpose*, the option being *either* to remit *or* to provide available funds *within* the transit time. The drawee bank could make payment, for instance, by drawing drafts upon another bank, or by transferring funds from another bank to the Reserve Bank, or by the shipment of currency to the Reserve Bank, or by permitting the cash letters to be charged against its reserve account at the expiration of the three-day period, and hence any one of these methods of payment were available to the drawee bank as a matter of right.

There is nothing in the Reserve Act which requires the reserve account to be kept intact for the purpose of meeting cash letters, but, on the contrary, Section 19 of the Federal Reserve Act (12 U. S. C. A. 464) expressly provides that the reserve account may be checked against or withdrawn, the language of the Act in that respect being as follows:

> "The required balance carried by a member bank with a Federal Reserve bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve

> Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities. * * *"

It is to be noted in this connection that the customers and depositors of the Reserve Bank sending the items to the Reserve Bank for collection are charged with notice of, and are bound by, the provisions of Circular No. 143, Regulation J, and, of course, statutory provisions, Circular No. 143 providing in that respect:

> "Conditions Under Which Items Will be Received.—Every bank sending checks or other cash items to the Federal Reserve Bank of Richmond, or to another Federal Reserve bank direct for our account, by such act will be understood to have agreed to the terms and conditions of this circular *and of Regulation J of the Federal Reserve Board.*"

Hence said customers and depositors are charged with notice of the fact that the drawee bank does have the option of making payment in the various ways specified, and does have the right entirely to deplete the reserve account.

It would therefore seem to follow that if the drawee bank was *not* obligated to pay the cash letters from the reserve account, nor required to preserve it intact to meet such cash letters, the reserve account can not be considered as security for the payment of said cash letters and hence no lien for that purpose existed against said reserve deposit.

A lien necessarily implies mutuality of the right on the one, and of the corresponding obligation on the other—the right of the creditor to the lien or security, and the obligation of the debtor to preserve the property intact to satisfy the lien—and if, instead of this, the debtor has the legal right entirely to dissipate or deplete the fund, it does not seem logical or consistent to hold that a lien on the fund exists in favor of the creditors whose items are contained in the cash letters. Certainly it would *not* seem to follow, as suggested by the court below, that a lien arises as soon as

> "the drawee bank either unequivocably accepts the checks, as in this case, or by failing to return them promptly becomes chargeable with them under the terms of the agreement." (R., pg. 71.)

(2) *The authority given the Reserve Bank by the drawee bank to charge the reserve account was not an assignment of the reserve account funds, and such authority was revoked by notice of suspension.*

Circular No. 143 *did* give the Reserve Bank authority to charge the account of the drawee bank, in the following language:

> "Therefore, the amount of any cash letter to a member bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter. The right is reserved, however, to charge a cash

> letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so." (R., pg. 55.)

In discussing the effect of this provision the court below took the position not only that said provision created an equitable lien, but that such lien amounted to an equitable assignment of so much of the funds as were necessary to pay the cash letters, its language in that respect being as follows:

> "And this right, we think, depends not upon the theory that the Reserve Bank is the owner of the checks or that it has the right of set off against the insolvent bank; but upon the fact that the contract of the parties has created an equitable charge upon the reserve account of the drawee bank and that such agreement operates as an equitable assignment of so much thereof as may be necessary to pay the checks when they are unequivocally accepted by the drawee. * * *" (R., pg. 72.)

There is, of course, a distinction between a lien upon a fund and an assignment of that fund, a lien being merely security for a primary debt and an assignment being a transfer of the ownership of the fund. Both, however, require integrity of the segregated or identified property, and if the lien be denied on the ground that the drawee bank was not obligated to pay the cash letters from the reserve account nor to preserve it intact for such payment, it would seem to follow, upon the same reasoning, that no assignment of the

reserve deposit was made. There can be no valid and effective assignment if the assignor has a legal right to dissipate and dispose of the property. The court below recognized this right of the drawee bank to dissipate the fund, but held, nevertheless, that the lien or assignment exists, and that only its value is affected by withdrawals from the fund, the opinion in that connection being as follows:

> "The depletion of the account may affect the value of the right of the owners of the checks; we do not see how it can affect the existence of the right. It is analogous to the right of the holder of a check in those jurisdictions where the giving of a check is held to be an equitable assignment pro tanto of the funds on which it is drawn. In such case the withdrawal of the funds before the presentation of the check may defeat the right of the holder, but this does not impair the holder's right in the fund if it is not in fact withdrawn before the insolvency of the drawer. * * *" (R., pg. 73.)

It will be noted, however, that there is a distinction between an equitable assignment and the contract provisions in the instant case. In an equitable assignment the assignor has no legal right to dispose of the property, but in the instant case the drawee bank did have the right to dispose of the property and had the right to make payment in some other manner.

It results that the right of the Reserve Bank, on behalf of its customers, to charge the reserve account was merely an unsecured authority to dispose of the

drawee bank's funds, such authority being alternative in application and executory in point of time, in that such authority could be exercised, in *normal course*, only in the event the drawee bank had not paid by some other method, and *still had available funds*, and then only at the expiration of the three-day period (subject, of course, to the right of immediate charge hereinafter discussed).

It is clear, of course, that if the drawee bank dissipates all of its reserve account, and also fails to make payment in some other manner within the three-day period, it violates its obligations to its creditors, but its conduct in that respect is no different from that of any other debtor who fails to pay his debts.

The situation, so far as the authority to charge the account is concerned, is analogous to one where the debtor has given a post-dated check which is to be used, or charged to his account, only in the event he has not paid the creditor in some other manner in the meantime. There is the obligation, in such case, to have funds on hand to meet the check at the due date, or else to have otherwise paid the debt in the interim. The post-dated check constitutes no more than an authority to the bank to charge the debtor's account on the due date. Can there be any question, in the light of well-settled principles, that, upon the insolvency or bankruptcy of the debtor before the due date of such check, the authority of the debtor to the bank is *immediately* revoked by such insolvency or bankruptcy?

Such is believed to be the situation here. The authority given the Reserve Bank was not to be exercised, in normal course, until the expiration of the three-day period. Before the expiration of such period, and therefore before the authority had been exercised, the debtor bank suspended on account of insolvency. By such suspension the authority theretofore given the Reserve Bank to charge the reserve account was revoked by operation of law, and all of the assets of the debtor bank, wherever located, including its deposit in the Reserve Bank, became the property of the Receiver for pro rata distribution among its creditors, and the depositors and customers of the Reserve Bank to whom the insolvent bank owed the items in the cash collection letters became entitled to file their claims with the Receiver for the amounts of their respective items.

There remains for discussion only the effect of the following provision of Circular No. 143:

> "The right is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so." (R., pg. 55.)

This provision, like the provision already discussed permitting the Reserve Bank to charge at the expiration of the three-day period, constitutes no more than an authority to charge the reserve acount. Such authority was not exercised in the instant case, prior to suspension, and hence suspension revoked the authority.

Conclusion.

It is respectfully submitted that the decision of t
lower court was erroneous and the petition for w
of certiorari should be granted.

Respectfully submitted,

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